Supreme Court, U.S.
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No. 99-552

IN THE

Supreme Court of the United States

SUN INTERNATIONAL NORTH AMERICA, INC.,

Petitioner,

v.

LAURANCE LOWENSCHUSS, TRUSTEE OF THE FRED LOWENSCHUSS ASSOCIATES PENSION PLAN and LAURANCE LOWENSCHUSS I.R.A.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

Petitioner asks this Court to consider whether the United States Court of Appeals for the Third Circuit erred when it applied 11 U.S.C. § 546(e) of the Bankruptcy Code to bar petitioner's pursuit of a fraudulent transfer action against petitioner's former shareholder arising out of a leveraged buyout transaction. Section 546(e) specifically excerpts from the Code's avoidance powers settlement payments (as defined by section 741(8) of the Bankruptcy Code) made by financial institutions, stockbrokers or securities clearing agencies to their customers. A settlement payment is *any* payment, preliminary or otherwise, commonly used in a securities transaction.The Third Circuit concluded that because the shareholder and petitioner utilized the services of a stockbroker and another financial institution to surrender the shares in exchange for payment, that consideration constituted a settlement payment and section 546(e) barred the petitioner's lawsuit. The Third Circuit held that the plain language of the Bankruptcy Code encompassed the payment at issue and that neither the statute nor the legislative history suggested that Congress intended a more narrow reading of the provision. Thus, the question presented is:

Whether the Third Circuit correctly interpreted section 546(e) to bar a debtor-in-possession or trustee from bringing a constructive fraudulent transfer action to recover a payment made by a financial institution or a stockbroker to a shareholder when the payment is a straightforward settlement transaction.

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OPINIONS BELOW

The opinion of the court of appeals is reported at 181 F.3d 505. Petitioner's Appendix ("Pet. App.") 1a-23a. The opinion of the district court is unreported. Pet. App. 24a-46a. The opinion of the bankruptcy court is also unreported. Pet. App. 47a-105a.

STATEMENT OF JURISDICTION

Respondents do not contest the Court's jurisdiction under 28 U.S.C. § 1254(1). Nonetheless, the respondents contend that should the Court grant the petition, the record will show that the bankruptcy court improperly exercised jurisdiction over the adversary proceeding and the respondents.

STATUTORY PROVISIONS INVOLVED

Although several provisions of the Bankruptcy Code and state law are implicated by this matter, the critical provisions include 11 U.S.C. § 546(e) of the Bankruptcy Code, which provides in relevant part:

> Notwithstanding sections 544, . . . 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment, as defined in section 101 or 741 . . . , made by or to a . . . stockbroker, financial institution, or securities clearing agency. . . .

11 U.S.C. § 546(e). Another important Code provision, section 741, defines a settlement payment to mean:

> a preliminary settlement payment, a partial settlement payment, an interim settlement payments, an interim settlement payment, a settlement payment on account, a final settlement payment on account, a final settlement payment

> or an other similar payment commonly used in the securities trade.

11 U.S.C. § 741(8).

STATEMENT OF THE CASE

In November 1988, Resorts International, Inc. ("RII"), the predecessor in interest to petitioner Sun International North America, Inc., offered all of its Class A common stockholders $36 per share as part of a leveraged buyout transaction ("LBO"). At the time, RII Class A shares were publicly traded on the American Stock Exchange. The Fred Lowenschuss Associates Pension Plan ("Pension Plan"), and the individual retirement accounts ("IRAs") of Laurance and Fred Lowenschuss[1] owned approximately 105,900 Class A shares combined (the "Shares").

RII forwarded a "Notice of Merger of Griffco Acquisition Corp. With and Into Resorts" and an attached Letter of Transmittal to all shareholders. The Notice of Merger provided that shareholders would receive the Merger Price when the Letter of Transmittal and certificates were presented to RII's agent, Chase Manhattan Bank ("Chase"), on or before November 15, 1989. The Letter of Transmittal also permitted appraisal shareholders (of which the Pension Plan was one) to withdraw their appraisal demand at any time in exchange for the merger consideration. RII's forms neither contained a time limit for withdrawal of appraisal requests nor were they amended, superseded or modified. Consistent with the Letter of Transmittal, the Pension Plan decided to withdraw its appraisal demand and tender its stock.

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1. Fred Lowenschuss and the 100 Shares in his IRA were severed from the case before trial, and he was not a party. Laurance Lowenschuss, as the representative of the Pension Plan and his IRA, is the respondent. For simplicity sake, the Pension Plan and the Laurance Lowenschuss IRA are collectively referred to as the Pension Plan.

The critical facts that bear on the petition relate to the Pension Plan Trustee's exchange of stock for payment in a typical settlement transaction. On July 17, 1989, the Pension Plan Trustee delivered the Shares to its stockbroker, Merrill Lynch, in accordance with RII's proxy materials. Merrill Lynch then forwarded the Shares through the normal brokerage process to Chase, which RII designated as its paying and transfer agent for the Shares. Chase took possession of the Shares. On July 27, 1989, Chase mailed Transfer Journal Sheets dated "07/26/89" to RII identifying the Pension Plan as having surrendered 105,700 shares. Therefore, both RII and Chase (RII's agent) knew that the Shares had been presented for payment.

As with every other surrender share of Class A stock, RII permitted its paying and transfer agent to settle the transaction. On August 1, 1989, RII wired $3,812,313.60 to Chase to pay, *inter alia*, for the Shares. Chase sent a $3,805,200 check payable to Merrill Lynch for the Shares. After receiving the payment, Merrill Lynch, in turn, paid the Pension Plan in full settlement of the surrendered Shares. RII similarly paid *every* tendering shareholder through November 3, 1989.

After the fact, RII determined, for various reasons, that it wanted its money back. RII filed a Complaint on September 26, 1989, in the United States District Court for the Eastern District of Pennsylvania ("Pennsylvania Court") naming Fred Lowenschuss individually and as Trustee of the two IRA's (but not as the Pension Plan Trustee). The record owner of the Shares, the Pension Plan, was not named or referenced in the Complaint. The Complaint sought to reverse the exchange of the Shares, for which RII paid $3.8 million. Fred Lowenschuss filed an Answer and Counterclaims.

After the filing of an involuntary bankruptcy petition on November 12, 1989 against RII in the United States Bankruptcy Court for the District of New Jersey, RII and

several affiliates either consented to or filed for chapter 11 relief.[2] This matter became an adversary proceeding before the bankruptcy court when RII "removed" it *directly* from the Pennsylvania Court, allegedly pursuant to 28 U.S.C. § 1452(a).

Although the case was filed in 1989, it took many years for it to proceed on the merits. RII's primary — and unique — argument was that its *own* proxy materials and conduct were an illegal contract, constituted a mistake or were the result of the Pension Plan Trustee's fraud. It was only after the removal of the action that RII filed an amended complaint that asserted constructive fraudulent transfer claims under N.J.S.A. 25:2-25(b) and 25:2-27(a) and under 11 U.S.C. § 548(a)(1)(B).[3] Thus, while arising in bankruptcy due to RII's chapter 11 filing, the matter primarily was a dispute involving simple, common law claims with the fraudulent transfer claims appended almost as an afterthought. On motions for partial summary judgment in February 1992, the bankruptcy court found the transfer to have been contrary to Delaware appraisal law but left the remedy and remaining mistake, fraud and fraudulent transfer counts for trial.

Having initially omitted the record owner of the Shares, RII moved to have the Pension Plan deemed a party, and by a June 13, 1995 Order, the Pension Plan was declared to have been a party from the case's inception in disregard of

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2. The Bankruptcy Court ultimately confirmed RII's Plan of Reorganization in 1990. *In re Resorts International, Inc.*, 145 B.R. 412 (Bankr. D.N.J. 1990). RII subsequently filed a second bankruptcy in the United States Bankruptcy Court for the District of Delaware in 1994. RII confirmed a second Plan of Reorganization that same year.

3. RII also asserted an actual fraudulent transfer claim under state and bankruptcy law. However, recognizing that it could not meet the requisite elements of this claim, RII abandoned it after trial.

prior contrary findings.[4] The bankruptcy court then severed the claims against Fred Lowenschuss individually from those against the Pension Plan and Laurance Lowenschuss's IRA and proceeded solely against the Pension Plan and IRA. At trial in November 1995, RII sought rescission and restitution on the grounds of mistake, fraud and illegal contract and to avoid the payment as a fraudulent transfer.

On April 22, 1997, the court issued an opinion, finding for RII as to mistake, fraud and illegal contract, dismissing the fraudulent transfer claims as barred by operation of section 546(e) of the Bankruptcy Code, and awarding $3,805,200, plus punitive damages of $250,000 and prejudgment interest against the Pension Plan. A judgment was entered on May 20, 1997. The court thereafter eliminated joint liability, limiting the judgment against the IRA to $3,600, plus punitive damages of $237 and interest of $1,561.84, and the Pension Plan to $3,801,600, plus punitive damages of $249,763 and interest of $1,649,373.53.

In an unreported opinion, the United States District Court for the District of New Jersey reversed the judgment on the mistake, fraud and illegal contract claims. Pet. App. 45a-46a. The district judge held that RII failed to prove even the most basic elements of the common law. Pet. App. 29a-43a n.7. The district court affirmed without substantial discussion of the bankruptcy court's dismissal of the fraudulent transfer claims.

The Third Circuit agreed with the district court that RII's common law claims had no merit. Pet. App. 6a-15a. The critical ruling for purposes of RII's petition was the circuit court's holding that section 546(e) of the Bankruptcy Code barred RII constructive fraudulent transfer claims against the

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4. The improper exercise of jurisdiction over the Pension Plan is also grounds for dismissal of the underlying adversary proceeding with respect to the Pension Plan.

Pension Plan. In particular, the Third Circuit found that the Pension Plan's use of Merrill Lynch as its stockbroker and RII's use of Chase to exchange the Shares for the settlement payment barred any suit against the Pension Plan. Pet. App. 22a. The panel found that RII's payment was a settlement payment as defined by the Code, given the broad language used by Congress in defining "settlement payment." Pet. App. 18a. The circuit court found *no* basis to limit the definition of "settlement payment" so as to exclude an LBO transaction.[5] Pet. App. 20a. The court also refused to ignore the statute as written by Congress: to bar all attempts to avoid payments by a stockbroker or financial institution to a shareholder using constructive fraudulent transfer causes of action. Pet. App. 20a-21a. The court concluded that there was no basis to ignore the plain language of the statute that would leave former public shareholders outside of the protections of section 546(e). Pet. App. 21a.

REASONS FOR DENYING THE WRIT

THE FRAUDULENT TRANSFER LAWS WERE NEVER APPLICABLE TO THE TRANSACTION BETWEEN RII AND THE PENSION PLAN

This Court may issue a Writ of Certiorari to consider matters where the petitioner has demonstrated that two or more circuit court rulings are in conflict over a question of national importance. Sup. Ct. R. 10(a). RII's petition suggests that a circuit conflict exists. However, the alleged conflict, if one exists at all, is simply not of the importance or nature to warrant review by this Court. Even if the Court were to

5. Indeed, no court has ever pointed to a specific passage of legislative history that shows Congress intended to *exclude* LBO transactions from the term "settlement payment". RII also fails to identify any specific legislative history that supports such an interpretation; rather it simply states that at the time section 546(e) was enacted, no one "suggested" that an LBO was the type of transaction that should come within the statute's reach.

ultimately consider the question, it is unclear whether it would reach the merits, as there are serious jurisdictional flaws in RII's underlying case discussed more fully in section C, *infra*. Moreover, given that there is no real conflict and that the Third Circuit's ruling is the correct decision, there is no need for review on the merits at this time. The question raised by RII is simply not one of great importance to the future interpretation of the Bankruptcy Code, and the Court should decline to issue a Writ of Certiorari.

A. While Section 546(e) May Be An Important Statute, The Issue For Which RII Seeks Review Is Not One Of National Importance.

It is not disputed that because of the sometimes conflicting goals of the federal securities laws and the Bankruptcy Code, Congress chose to exempt certain securities transactions from the trustee avoidance powers of the Bankruptcy Code. Indeed, in section 546(e) of the Code, Congress decided to exempt any payment made by or to a stockbroker or other financial institution in exchange for the tender of securities from the application of constructive fraudulent transfer law.

RII's petition focuses on whether a particular type of transaction, a leveraged buyout, qualifies as a securities transaction within the meaning of section 546(e). RII argues that the Third Circuit was mistaken in applying section 546(e) to an LBO for two reasons. First, RII asserts that because of the nature of an LBO transaction, the brokerage and financial institutions in the settlement chain are not "transferees" but mere conduits, thereby permitting the courts to ignore such entities' presence in the transaction. Second, RII argues that LBO payments received by a shareholder from an entity in the securities clearance chain are not "settlement payments" as defined by the Bankruptcy Code. In seeking the writ, RII argues that answering these questions is an issue of critical national importance. This is simply not the case.

What RII seeks is to have this Court consider is an issue that has its roots in a financial practice that was a product of the 1980s' merge and acquisition mania. While still occurring today, LBOs are less frequent and take a substantially different form from the 1980s version. As a result, the issues are not likely to be important in the bankruptcy context in the future.

By definition, a leveraged buyout involves the takeover of a company using borrowed funds. *See* DICTIONARY OF FIN. & INV. TERMS 297-98 (John Downes & Jordan Elliot Goodman eds., 4th Ed. 1995). Often, the target company's assets serve as the collateral for the loans used to finance the purchase. *Id.* The acquiring company then repays the loans from the target entity's profits or by selling the target's assets. *Id.* During the 1980s, many leveraged buyouts were financed through the issuance of "junk bonds". *Id.* at 284. Junk bonds are corporate debt instruments that involve greater than usual risk as an investment and pay a relatively high rate of interest. *Id.* Such bonds are typically issued by a company lacking an established earnings history or having a questionable credit history. *Id.*

In the past, when companies were acquired through LBOs, the target's debt burden was often too large for the target to handle. This fact resulted in a rash of corporate bankruptcies in the late 1980s and early 1990s, as well as portfolios of valueless junk bonds. *See* John Greenwald, *LBOs: Let's Bail Out if the Economy Goes South, Debt-Heavy Buyouts Could Go Under*, Time, Aug. 14, 1989, at 50. Many otherwise financial sound companies were the victims of LBO mania. *See, e.g., id.* RII was one target company that could not meet its debt burden and which ultimately was forced to seek chapter 11 protection twice.

It is estimated that during the 1980s, at least $500 billion in LBO transactions took place. During the 1990s, companies transacted just a fraction of the number and amount of LBOs,

while at the same time, total equity market capitalization has soared to unprecedented levels.[6] The financing of LBOs has also changed radically since 1990. The overwhelming majority of recent LBOs were financed in a manner other than through the junk bond market. *See* Merrill Goozner, *Investors Flocking to Junk Bonds, But Risks Are Not for Everyone*, Dallas Morn. News, June 15, 1997. Thus, post-LBO companies of today appear financially more sound than their 1980's counterpart.

Of particular interest is the fact that the impact of the leveraged buyout to the bankruptcy process has all-but-disappeared. Even the most recent circuit cases, the one

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6. Considering the relative value of publicly traded companies in 1980s as opposed to the 1990s further reinforces the loss of importance of LBOs in today's business world. In 1990, total market capitalization of all publicly traded companies on the New York Stock Exchange was estimated to be $2.6 trillion. William E. Sheeline and Alan Deutschman, *Money & Markets: Who Needs The Stock Exchange? We All Do, Because It Is The Central Marketplace That Sets The Prices For Investors. But America's No. 1 Exchange Is Threatened With Unplanned Obsolescene*, Fortune, Aug. 19, 1990. $500 billion in LBO transactions during the 1980's constituted a not insubstantial percentage of market capitalization. Since 1990, the total market capitalization of the New York Stock Exchange has more than quadrupled, exceeding $11.3 trillion, while total market capitalization of all United States exchanges exceeds $28 trillion. *Hearings on Proposals Certified to Save Social Security Before the House Committee on Ways and Means*, 106th Cong., 1st Sess. (1999) (statement of the Honorable Marshall "Mark" Sanford, M.C., South Carolina) (available on the internet at www.house.gov/ways_means/hearin.htm). By comparison, from 1996 to 1998, the three most-active LBO years since 1989, only about $84 billion in LBO transactions took place. *See Buyout Deals Reach $41 Billion*, UPI, Jan. 1, 1999; Matthew Schifrin, *LBO Madness*, Forbes, Mar. 9, 1998, p. 128; Tom Petruno, *Buyouts Are Back. LBOs, One Symbol of Greed in '80s, Are Giving Stock Market a Boost*, Minneapolis Star Tribune, Dec. 12, 1996, p. 01D. As a percentage of market capitalization, LBOs are simply not significant.

before this Court now and *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604 (11th Cir. 1996), *cert. denied, sub nom. Dimensions Group, Inc. v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739, *and Munford v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739 (1998), were the result of LBO transactions that occurred nearly ten years ago. None of the lower court cases cited in RII's petition appears to involve an LBO that took place more recently than 1991. And, given today's business climate, the unwinding of LBO transactions is not likely to be an important feature of future bankruptcy cases.

After the failure of many LBOs, it is not surprising that creditors, trustees and debtors-in-possessions turned to the fraudulent transfer laws to attempt to recover some of their losses. In cases that did not involve the securities process, section 546(e) was no bar to recovery under a fraudulent transfer theory. However, when lawsuits started to include shareholders of publicly traded companies, section 546(e) of the Bankruptcy Code on its face seemed to bar fraudulent transfer actions. *See, e.g., Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1240 (10th Cir. 1991). Several courts have attempted to circumvent 546(e), ostensibly relying upon what Congress allegedly intended when enacting section 546(e). As discussed *infra*, the rationale put forth by these courts was unnecessary as the facts surrounding the transactions clearly put them outside of the scope of the securities clearance system. Thus, it is difficult to image how such a ruling by the Court in this proceeding will provide more guidance than the Third Circuit has already provided.

B. The Record Below Will Not Support A Ruling That Will Resolve The Alleged Conflict Between The Circuits.

The Third Circuit concluded that the Pension Plan's utilization of Merrill Lynch as its stockbroker and RII's use

of Chase as its paying and transfer agent insulated the LBO transaction from the reach of the avoidance powers. Pet. App. 22a. In reaching that determination, the panel noted that it was not in agreement with the reasoning of the majority in the Eleventh Circuit case in *In re Munford*, at least as to whether the transfer was made to or by a protected entity. Pet. App. 21. The Third Circuit also noted that it did not agree with several district court cases which had ruled that receiving consideration in exchange for delivery of shares in an LBO was not a "settlement payment" as defined by the Bankruptcy Code. Pet. App. 19a. However, regardless of the Third Circuit's disagreement with the reasoning of those cases, there is neither a true circuit conflict nor a meaningful conflict with any of the district court rulings.

It is important to note a critical factual distinction between the transaction in *Munford* and the one in this case. In *Munford*, the debtor's shareholders delivered their shares directly to a bank that held the debtor's funds in trust to pay for the shares. 98 F.3d at 610. According to the circuit panel, the bank did not obtain a "beneficial interest in the funds" as it was not serving as an entity in the securities clearance chain.[7] *Id.* Consequently, the Eleventh Circuit held that the bank was merely a conduit for the transfer of the funds to the former shareholders. *Id.* The *Munford* Court effectively collapsed the transaction so that it involved a transfer of stock directly to the target corporation in exchange for payments directly to the shareholders.

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7. The district court found that the bank was holding the funds deposited by the debtor as trust funds and was effectively nothing more than an escrow agent. *See Munford, Inc. v. Munford*, 188 B.R. 860, 863 (N.D. Ga. 1996), *aff'd in part, rev'd in part sub nom. Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604 (11th Cir. 1996), *cert. denied, sub nom. Dimensions Group, Inc. v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739, *and Munford v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739 (1998). There is no such finding in this case.

In this case, Chase did not hold the payment as a trust fund or merely serve as an escrow agent. Rather, RII admitted Chase served as both its paying and transfer agent. The common understanding is that paying agents are responsible for paying dividends or making other distributions on behalf of the corporation to shareholders. DICTIONARY OF FIN & INV. TERMS at 410. Transfer agents are responsible for maintaining shareholder records and canceling and issuing shares on behalf of the corporation. *Id.* at 615. Thus, it appears that Chase was operating in the context of the securities settlement process when it accepted delivery of the Shares and forwarded the funds to Merrill Lynch that ultimately were used to pay the Pension Plan.

Second, there was an additional entity in this transaction that was not present in *Munford*. The Pension Plan employed Merrill Lynch, its stockbroker, to effectuate the transaction. A " 'stockbroker' means [a] person . . . with respect to which there is a customer, as defined in section 741(2) of this title. . . ." 11 U.S.C. § 101(53A)(A). A "customer" is defined, in relevant part, as

> (A) entity with whom a person deals as principal or agent and that has a claim against such person on account of a security received, acquired, or held by such person in the ordinary course of such person's business as a stockbroker, from or for the securities account or accounts of such entity — . . .
>
> (ii) with a view to sale; . . .
>
> (B) entity that has a claim against a person arising out of —
>
> (i) a sale or conversion of a security received, acquired, or held as specified in subparagraph (A) of this paragraph; or

> (ii) a deposit of cash, a security, or other property with such person for the purpose of purchasing or selling a security;

11 U.S.C. § 741(2). According to the Sixth Circuit, "the legislative history [of section 741(2)] suggests that a customer includes 'anybody that interacts with the [alleged stockbroker] in a capacity that concerns security transactions.' " *WesBanco Bank Barnesville v. Rafoth (In re Baker & Getty Fin. Svcs., Inc.)*, 106 F.3d 1255, 1260 (6th Cir.), *cert. denied*, 118 S. Ct. 65, 139 L. Ed. 2d 27 (1997), *quoting* H.R. Rep. No. 95-595 (1977), *reprinted in* 1978 U.S. Code & Cong. Ann. News. 6223-27. The Sixth Circuit also noted that

> the definition of customer turns on the *purpose of the* [investor] rather than the status or intent of the [stockbroker]. An investor qualifies as a customer when the investor *deposits money or securities* with the [stockbroker] with the expectation that the [stockbroker] purchase stock or trade securities.

Id. (emphasis supplied). The *WesBanco* panel also rejected the contention that because the entity may have not been executing a securities trade on behalf of the customer in a particular circumstance, the entity lost its status as a stockbroker for that particular transaction. *See id.* at 1262 (unlicensed broker that converted customer deposit for its own purposes rather than to conduct a trade remained a stockbroker as it had engaged in trades on behalf of other customers in the past). Therefore, if an entity is a stockholder, the Code treats all transfers of property, stock or cash to have taken place in a stockbroker-customer relationship.

The Pension Plan was a "customer" within the meaning of the Bankruptcy Code. It delivered securities or "property"

to Merrill Lynch in the anticipation that Merrill Lynch would complete the stock purchase transaction. Since it cannot seriously be disputed that Merrill Lynch was a stockbroker at the time of the transaction as defined by the Bankruptcy Code,[8] it follows that section 546(e) has specifically exempted payments *by or to* Merrill Lynch from the reach of the avoidance powers. This relationship did not exist in *Munford*, strongly suggesting that the reasoning of *Munford* is inapplicable here.[9]

While RII acknowledges that there is no circuit-level conflict as to the definition of "settlement payment," it seeks to elevate supposed conflicts at the district court level to ones of substantial importance. However, as with the *Munford* case, the record relied upon by the Third Circuit to determine that the payment here constituted a settlement payment

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8. Even if the Pension Plan were not a customer, Merrill Lynch has hundreds of thousands of customers who utilize Merrill Lynch as a stockbroker. Thus, for purposes of section 546(e), Merrill Lynch qualifies as a stockbroker. *See WesBanco*, 106 F.3d at 1262.

9. RII attempts to elevate two circuit decisions addressing the "mere conduit" theory under 11 U.S.C. § 550, *Christy v. Alexander & Alexander of New York Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey)*, 130 F.3d 52, 59 (2d Cir. 1997), and *Bonded Fin. Svcs. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988), as cases in conflict with the Third Circuit's decision here. Neither case had anything to with the application of section 546(e) or LBO transactions. More importantly, the more specific Code section, section 546(e), operates without reference to the requirements of the more general section 550. Section 546(e) simply exempts from the reach of the trustee or debtor any person receiving payments from one of the specified entities. There is no requirement that the specified entity also be considered a transferee for purposes of fraudulent transfer law. Rules of statutory construction therefore run counter to RII's argument. *Simpson v. United States*, 435 U.S. 6, 7 (1978) ("precedence should be given to the terms of the more specific statute where a general statute and a specific statute speak to the same concern . . .").

differs sharply from the facts in the lower court cases cited by RII. This factual difference naturally limits the importance of a ruling on the merits.

For example, in *Zahn v. Yucaipa Cap. Fund*, 218 B.R. 656, 676 (D.R.I. 1998), there was simply *no* exchange of stock for cash through any of the entities listed in section 546(e). In fact, the stock in *Zahn* was even not publicly traded, and, thus did not implicate the securities settlement system in any way.[10] *Id.* Similarly, in *Jewel Recovery, L.P. v. Gordon*, 196 B.R. 348, 353-54 (N.D. Tex. 1996), *Brandt v. Hicks, Muse & Co., Inc. (In re Healthco Internat'l, Inc.)*, 195 B.R. 971, 981 (Bankr. D. Mass. 1996) and *KSC Recovery, Inc. v. First Boston Corp. (In re Kaiser Merger Litigation)*, 168 B.R. 991, (D. Colo. 1994), each court held section 546(e) to be inapplicable because the shareholders were not paid by any one of the listed entities in section 546(e), and in the case of *KCS Recovery*, the alleged payments were found to have predated the LBO and to have been made in return for proxies and options for new shares. Factually, each case differs radically from this case below and, by definition, fall outside the scope of section 546(e).

In *Wieboldt Stores, Inc. v. Schottenstein*, 131 B.R. 655 (N.D. Ill. 1991), a district court held that payments of LBO consideration were not settlement payments. The case is again distinguishable because of important factual differences. First, as in *Munford*, the financial institution in question did not appear to be functioning as anything more than an escrow agent for the acquired entity; thus, the entity's role and the roles of Chase and Merrill Lynch here differed

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10. RII suggests in footnote 15 of the petition that the *Zahn* Court's refusal to apply section 546(e) to an alleged private stock sale intermediary that was not specifically named in the statute was the elevation of substance over form. Respondent respectfully suggests that a more plausible basis for the *Zahn* Court's decision is that was merely applying the statute as written.

substantially. Second, the district court ruled that although the legislative history was not dispositive and the statute appeared facially applicable, it was free to ignore the statute's language because in that particular transaction, the court was unable to perceive of any risk to the clearance and settlement chain. *Id.* at 665-66. Thus, the *Wieboldt* case is a classic example of legislation by judicial fiat. In fact, all the circuits considering section 546(e) have rejected or sharply criticized the reasoning of *Wieboldt*, one noting that:

> On its face, the statute is clear. The statue exempts payments made "by or to" a stockbroker, financial institution, or clearing agency. Again, unless there is some reason to believe the clear application is abused and otherwise unreasonable we leave our inquiry at that.

In re Kaiser Steel, 952 F.2d at 1240 (emphasis supplied). *See In re Munford, Inc.*, 98 F.3d at 610 n.4 ("We reject the reasoning of *Wieboldt[,]* finding that even granting trustees avoidance powers under limited circumstances in the LBO context has the potential to lessen confidence in the commodity market as a whole.").

C. The Trial Court Lacked Jurisdiction Because Of The Improper Removal From The Pennsylvania Court.

There is a serious jurisdictional flaw that would likely prevent the Court from reaching the merits upon the granting of a writ.[11] After the initiation of RII's bankruptcy, RII removed this case directly from the Pennsylvania Court under 28 U.S.C. § 1452 to the bankruptcy court. In upholding the "direct removal," the lower courts rejected case law that held

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11. In addition, respondents believe that the bankruptcy court's order that permitted RII to "amend the caption" to add the Pension Plan Trustee as a party was also error. Reversal of that order would also deprive the bankruptcy court of jurisdiction.

that a direct removal is in contravention of the removal statute and 28 U.S.C. § 157(a).

The majority of cases that have addressed "direct removal" have rejected it and found it to be a void act. *See Cornell & Co., Inc. v. Southeastern Pa. Transp. Auth. (In re Cornell & Co., Inc.)*, 203 B.R. 585 (Bankr. E.D. Pa. 1997); *Thomas Steel Corp. v. Bethlehem Rebar Indus., Inc.*, 101 B.R. 16 (Bankr. N.D. Ill. 1989). While some decisions like *Cornell* involved a transfer between courts in the same district, other cases make it clear that section 1452 does not allow a transfer from *any* court directly to the bankruptcy court. *Furr v. Barnett Bank of Marion Cty. (In re S & K Air Power of Fla., Inc.)*, 166 B.R. 193 (Bankr. S.D. Fla. 1994); *Centrust Sav. Bank v. Love*, 131 B.R. 64, 66-67 (S.D. Tex. 1991). *But see In re Princess Louise Corp.*, 77 B.R. 766 (Bankr. C.D. Cal. 1987) (allowing direct removal to a bankruptcy court).

In *Centrust*, the court identified the jurisdictional flaw in direct removal, noting that in enacting section 1452, Congress expressly limited removal to "the district court." *Id.* at 66. The court then emphasized that:

> [B]ankruptcy courts receive cases by referral, never by removal. Like other case management orders, the referral is left to the discretion of the district court. . . . Proper procedure to have the case reach the bankruptcy court is to petition the district court for an order of reference.

Id. The court also stressed that "[s]ection 1452 is part of *Chapter 89: Removal of Cases from State Courts*. By its terms, it does not provide for removal from federal district court." *Id.* at 67.

Although Third Circuit summarily dismissed the jurisdictional argument (Pet. App. 22a n.12), the majority of

cases hold that any transfer between a federal district court to a bankruptcy court in another district must occur at the district court level. The proper step would then be to refer the matter under section 157(a), the only permissible basis for a bankruptcy court to exercise jurisdiction.[12] Because improper removal results in a void act, should this Court grant the writ, it would likely dismiss the case as having been improperly removed by RII.

D. Even If The Court Were To Grant The Petition, The Third Circuit's Decision Is The Proper One And Would Be Affirmed.

Section 546 expressly limits a debtor's right to pursue fraudulent transfers, preferences or other avoidance actions that involve "settlement payments" by or to a stockbroker or other institution. 11 U.S.C. § 546(e). Section 741 defines a settlement payment as broadly as possible and specifically notes that it any "other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8). *See also* 11 U.S.C. § 101(51A) (similar definition as to forward contracts).

This Court has consistently admonished lower courts to literally apply federal statutes, except in those rare cases where the language will produce an absurd result or one that is clearly at odds with Congress's intent in drafting the statute. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989). One of the basic premises put forth by this Court is that where Congress attaches no qualifiers or modifiers to a phrase, courts should not place limitations on the statute's scope. *See Lewis v. United States*, 455 U.S. 55, 60 (1980). Thus, the addition by judicial fiat of language to an unambiguous statute cannot be considered a natural reading of the statute.

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12. Notably, RII did not repeat its error when seeking to transfer a later proceeding between districts and *then* moving to have it referred pursuant to 28 U.S.C. § 157. *Laurance Lowenschuss v. Resorts International, Inc.*, 194 B.R. 339, 343, 350 (D.N.J. 1996).

The Third Circuit has commented extensively on the application of section 546(e), first, in *Bevill, Bresler & Schulmar Asset Mgmt. Corp. v. Spencer Sav. & Loan Ass'n*, 878 F.2d 742, 747 (3d Cir. 1989), and now in this case. Although the *Bevill* case involved section 546(f) in a "repo" transaction, the panel's ruling relied on the legislative history of section 546(e), upon which subsection (f) was modeled. In examining section 546(e), the *Bevill* Court concluded that the important policies behind the avoidance powers were "on a collision course" with the important policies of the securities laws. *Id.* at 751. According to the *Bevill* Court, Congress decided to remedy the conflict by:

> remov[ing] the right . . . to avoid transactions under certain circumstances. Thus, . . . the 1982 amendments were designed in cases of securities in general to "ensure that the avoiding powers of a trustee are not construed to permit margin or settlement payments to be set aside except in cases of fraud [by the purchaser]."

Id. at 751, *quoting* H. Rep. No. 97-420, 97th Cong., 2nd Sess. 1 (1982), U.S. Code Cong. & Admin. News 1982, p. 583. In addition to Congress's stated intent to protect the commodities and securities market by preventing the insolvency of a securities firm from spreading to other firms, the Third Circuit noted an additional and more expansive legislative intent in enacting section 546(e), emphasizing that:

> Congress wanted to go further to protect margin payments and settlement payments made by and to *participants* in the securities market *generally*. Accordingly, it add a new subsection to . . . § 546. . . .

Id. at 747 (emphasis supplied). Thus, the Third Circuit concluded that the exemption of settlement payments from

avoidance actions contained in section 546(e) was "extremely broad." *Id.* at 751.

Exhibiting consistency, the Third Circuit maintained its broad and literal interpretation of section 546(e) in this case, stating that,

> [i]n the securities industry, a settlement payment is generally the transfer of cash or securities made to complete a securities transaction. . . . Here, the securities passed from Lowenschuss's broker, Merrill Lynch, to the transfer bank, Chase Manhattan. Resorts wired funds to Chase which Chase then forwarded them to Merrill Lynch who paid Lowenschuss. Although no clearing agency was involved in this transfer, two financial institutions — Merrill Lynch and Chase — were. Under a literal reading of section 546, therefore, this was a settlement payment "made by . . . a financial institution."

Pet. App. 19a (internal citations omitted). According to the Third Circuit, the broad interpretation compels a conclusion that all securities transactions are to be included in the definition of settlement payments. Neither the *Bevill* panel nor the panel below noted any contrary intent expressed in the legislative history.

The Tenth Circuit has also broadly interpreted section 546(e) to include LBO consideration as settlement payments. *Kaiser Steel Corp. v. Pearl Brewing Co.*, 952 F.2d 1230, 1239-40 (10th Cir. 1991), *cert. denied*, 505 U.S. 1213 (1992). Thus, a beneficial shareholder that received a payment from its broker in exchange for shares is protected from section 544 and 548(1)(B) actions. *Id.* at 1240-41. Indeed, the transaction in *Kaiser Steel* is almost identical to the transaction in this case. In *Kaiser Steel*, the LBO agreement provided that Kaiser would be purchased for $162 million

by outside investors through a merger with a new entity owned entirely by the investors. *Id.* at 1235. Upon the merger, all common stock shareholders received the right to a $22 per share payment and shares of preferred stock, which the Tenth Circuit identified as the "LBO consideration." *Id.* After the merger, shareholders tendered shares to Kaiser's disbursing agent through brokers and intermediaries in return for the LBO consideration. *Id.* at 1235-36.

After Kaiser Steel filed Chapter 11, a trustee sought to avoid the payments, arguing that section 546(e) did not apply to LBO's. *Id.* at 1238-39. The court refused to narrow the scope of section 546 and rejected the argument:

> The former . . . shareholders effectively sold their interests to new investors for money and a continuing stake in the new entity as preferred shareholders. In settlement, the . . . shareholders tendered their shares and received payment. These payments were "settlement payments. . . ."
>
> [Such] investors[s] will not be forced to disgorge the payments several years later.

Id. at 1239-40. The court also rejected the argument that payments by brokers to equity securities holders were not covered. The court held that the "clear application" includes "settlement payments *by* or to" a stockbroker in any context and would, therefore, include payments by a broker to a shareholder. *Id.* at 1240 (emphasis supplied). There is no question that the merger consideration was a settlement payment first made by Chase, a protected entity, to Merrill Lynch, a protected entity, and then to the Pension Plan by Merrill Lynch.[13]

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13. RII would not be successful even if this Court were to consider the merits. The record evidence uniformly points to a per share value of at least $36 on the merger date and also demonstrates (Cont'd)

Courts that graft additional requirements onto the statute are not following the plain language rule. As noted by the Third Circuit, the Bankruptcy Code does not require that a settlement payment be one that involves a transfer of the beneficial interest in a stock. Pet. App. 21a. Courts that impose such a requirement are therefore acting in contravention of the plain language of the statute. Similarly, RII's argument that the *Munford* case compels one to consider first whether an entity satisfies the definition of "transferee" under 11 U.S.C. § 550 before applying section 546(e), is contrary to the express language of the Code and the rules of statutory construction, that is, the more specific statute takes precedence over the more general. *Simpson v. United States*, 435 U.S. 6, 7 (1978). There is no requirement that the listed entity in section 546(e) must be a transferee for purposes of fraudulent transfer law.

RII's suggestion that the Third and Tenth Circuits ignored the legislative intent of section 546(e) is similarly insupportable. In fact, at least one district court has admitted that the legislative history is in no way dispositive. *Wieboldt Stores*, 131 B.R. at 665. Based upon its review of the legislative history of section 546 in *Bevill*, the Third Circuit determined that Congress intended to protect *all* participants in the securities markets generally from being forced to disgorge funds in bankruptcy cases. No one, including RII, has pointed to specific legislative history that warrants a determination to the contrary. At best, RII can only suggest that such an intent was not contemplated. However, if Congress had intended to limit the bar of section 546(e), it certainly knew how. For example, Congress could have simply modified the language of the statute to make it

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(Cont'd)
that the Pension Plan waived its rights of appraisal in exchange for the merger consideration. Both facts would constitute an exchange of reasonably equivalent value, which defeats RII's fraudulent transfer argument.

inapplicable to payments to shareholders, as it did when it permitted trustee's and debtors-in-possession to pursue settlement payments that constitute actual fraudulent transfers.

CONCLUSION

A Writ of Certiorari should not be granted because the issue is not one of national legal import. The decline in popularity and the financial evolution of the leveraged buyout suggest that it will not have a meaningful impact in the bankruptcy context in the coming years. Moreover, the ruling by the Third Circuit is factually unique and therefore a decision on the merits is not likely to resolve the alleged conflicts. There is also a serious jurisdictional question that would likely prevent the Court from considering the merits in any event. Finally, the Third Circuit's ruling is simply the correct decision, and there is no need for review at this time. In sum, the petition does not raise an issue of great importance to the future interpretation of the Bankruptcy Code. Accordingly, this Court should decline to issue a Writ of Certiorari.

Respectfully submitted,

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